panarctic oils ltd

1988

ANNUAL REPORT

Corporate Information

Corporate Profile

Panarctic Oils Ltd., an industry/government consortium, is owned more than 50 percent by the Government of Canada through Petro-Canada Inc., with the remainder of the shares held by 36 largely Canadian corporate or individual shareholders. Panarctic explores for oil and natural gas in the Canadian Arctic Islands north of the Canadian mainland. This effort has resulted in the discovery of large reserves of natural gas and modest amounts of crude oil. Gas reserves represent a 20 percent addition to Canada's gas supply. Company efforts are currently directed to producing and distributing small volumes of crude oil to Northern and Southern Canadian markets.

Head Office

Incorporated May 27, 1966
by Federal Letters Patent
Head Office
815 Eighth Avenue South West
Calgary, Alberta T2P 3P2

Bankers

Bank of Montreal
Calgary, Alberta

Auditors

Price Waterhouse
Calgary, Alberta

Annual Meeting

The annual meeting of shareholders of Panarctic Oils Ltd. will be held in the Company's head office located at Panarctic Plaza, 815 Eighth Avenue South West, Calgary, Alberta on Thursday, June 1st, 1989 at 9:00 a.m. M.D.T.

Officers

JOHN M. TAYLOR
Chairman of the Board

WILBERT H. HOPPER
Vice-Chairman of the Board

CHAS. R. HETHERINGTON
President and Chief
Executive Officer

COLIN S. MacDONALD
Vice-President and
Secretary-Treasurer

F. R. MATTHEWS, Q.C.
Assistant Secretary

K. GREY ALEXANDER
Assistant Secretary and
Manager of Operations

CORINNE E. DAVEY
Assistant Secretary

President's Report

Panarctic in 1988 marked the fourth year of its Bent Horn crude oil production and marketing operation .

The Company produced 347,149 barrels of crude from the Bent Horn A-02 well during the period July 4, 1988 and September 30, 1988 .

Two successful voyages were made during the year delivering 295,968 barrels of crude to northern and eastern markets including 11,200 barrels to the Northern Canada Power Commission at Resolute Bay. These sales provided Panarctic with earnings of approximately $2.0 million.

In 1989 Panarctic will continue its oil production operation and, assuming the crude oil price maintains an economic level, will attempt three shipments. Early in the 1989 season cumulative production from the Panarctic et al Bent Horn A-02 well will exceed 1 million barrels.

The Company will also be conducting a geophysical and geological review in 1989 of certain oil prone regions in the Arctic Islands with a view to identifying future potential crude oil prospects on land.

Panarctic continued to operate with a small full time staff complimented by temporary employees for field activities. The Company's financial position remains in good shape with a cash position of $19.8 million and no current or long-term debt .

During the year two Directors resigned from the Board. Panarctic would like to express its appreciation to John Beddome for his seven year contribution to the Board, and to Barry Stewart for his four year contribution.

The Company thanks its employees for their contribution during 1988 and records its appreciation of the efficient way in which they carried out their duties.

Chas. R. Hetherington

Chas. R. Hetherington
President and Chief
Executive Officer

Calgary, Alberta
February, 1989

BOARD OF DIRECTORS

JOHN ANDRIUK*
Senior Vice-President
Exploration and Land
Dome Petroleum Limited

C. BARRIE CLARK**
President
PanCanadian Petroleum Limited

J. A. DILLABOUGH**
Senior Vice-President,
Production
Canadian Hunter Exploration Ltd.

DALLAS E. HAWKINS
President
Drake Petroleum

CHAS. R. HETHERINGTON*
President and Chief
Executive Officer
Panarctic Oils Ltd .

WILBERT H. HOPPER
Chairman and Chief
Executive Officer
Petro-Canada Inc.

PETER KAYE*
Senior Vice-President
Exploration
Petro-Canada Resources

EDWARD M. LAKUSTA*
President and Chief
Operating Officer
Petro-Canada Inc.

RODNEY T. McGRATH
Vice-President and
General Manager of Operations
Petro-Canada Resources

NORMAN F. McINTYRE
Vice-President
Production Development
Petro-Canada Resources

WILLIAM MORROW**
Vice-President and Controller
Petro-Canada Inc.

DAVID P. O'BRIEN*
Executive Vice-President**
Petro-Canada Inc.

OWEN E. OWENS
Vice-President, Exploration
Cominco Ltd.

DAVID E. POWELL*
Executive Vice-President and
Chief Operating Officer
Home Oil Company Limited

ROLLIN W. PRATHER
Businessman
Calgary, Alberta

JAMES M. STANFORD*
President
Petro-Canada Resources

JOHN M. TAYLOR
Businessman
Calgary, Alberta

WILLIAM B. THOMPSON
Vice-President and General
Manager, Canadian Exploration
Petro-Canada Resources

C. ROLF V. THOMSON
Vice-President, Exploration
PanCanadian Petroleum Limited

* Member of the Executive Committee of the Board
** Member of the Audit Committee of the Board

FIVE YEAR OPERATING AND FINANCIAL SUMMARY

	1988	1987	1986	1985	1984
Gross Exploration Expenditures Capitalized					
Geological and Geophysical	$ 1	$ 3	$ 326	$ 369	$ 1,104
Drilling	191	9,478	9,693	19,624	29,315
Administrative and General Expense	(426)	3,294	8,172	6,435	6,941
Interest Expense	4	5	22	110	1,034
Crude Oil Income	(1,985)	(3,111)	(686)	(1,982)	-
Total*	$ (2,215)	$ 9,669	$ 17,527	$ 24,556	$ 38,394
Cumulative Exploration*	$439,337	$441,552	$431,883	$414,356	$389,800
Share Capital as at December 31					
Number of Shares	70,172	70,172	70,172	70,172	68,005
Capital	$298,712	$298,712	$298,712	298,712	$297,121
Landholdings at December 31					
Gross Hectares	324	538	5,426	11,977	11,957
Net Hectares**	129	275	1,603	4,715	4,691

* Before Petroleum Incentives Program grants, seismic sales, investment income and other sundry credits.

** Subject to 10 percent net profits interest.

NOTE: All amounts shown in the summary are in thousands.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements and other financial information relating to the Company contained in this annual report have been prepared by Management, which is responsible for the integrity and objectivity of this information. The financial statements have been prepared in conformity with generally accepted accounting principles. These financial statements necessarily include some amounts that are based on informed judgments and best estimates of Management.

Management depends upon a system of internal accounting controls to meet its responsibility for reliable and accurate reporting. Management modifies and improves the system of internal accounting and controls in response to changes in business conditions and exercises its judgments in business in determining that a reasonable balance is maintained between the costs of such controls and the benefits to be derived therefrom.

Price Waterhouse, Panarctic's independent auditor, is engaged to express a professional opinion on the financial statements. The examination is conducted in accordance with generally accepted auditing standards and includes tests and other procedures which allow them to report on the fairness of the financial statements prepared by Management.

Four non-Management directors of the Company serve as the Audit Committee. The Board of Directors, through the Audit Committee, oversees Management's responsibilities for financial reporting. The Audit Committee meets with Management and the independent auditor to discuss auditing and financial matters and to gain assurance that its responsibilities are being carried out. The independent auditor has full and free access to the Audit Committee.

AUDITORS' REPORT

To the Shareholders of Panarctic Oils Ltd.

We have examined the consolidated balance sheet of Panarctic Oils Ltd. as at December 31, 1988 and the consolidated statements of exploration expenditures and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1988 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse

Calgary, Alberta
January 31, 1989

Price Waterhouse
Chartered Accountants

Consolidated Balance Sheet

(thousands of dollars)	December 31 1988	1987
ASSETS		
Current Assets:		
Cash and term deposits	**$ 19,846**	$ 12,161
Accounts receivable	**315**	489
Petroleum Incentives Program grants receivable	**—**	3,793
Inventory of supplies (Note 5)	**6,318**	6,428
Prepaid expenses and sundry advances	**113**	12
	26,592	22,883
CAPITAL ASSETS, at cost:		
Equipment (Note 2)	**81,978**	82,327
Less: Accumulated depreciation	**(76,668)**	(75,076)
	5,310	7,251
Exploration expenditures (Note 5)	**266,967**	270,296
	272,277	277,547
	$298,869	$300,430
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued liabilities	**$ 157**	$ 1,718
	157	1,718
SHAREHOLDERS' EQUITY:		
Share Capital (Note 4)		
Authorized - Unlimited common shares of no par value		
Issued - 70,171,964 shares	**347,281**	347,281
Petroleum Incentives Program grants on shareholder financed expenditures	**(48,569)**	(48,569)
	298,712	298,712
Contingencies and Commitments (Note 5)		
	$298,869	$300,430

Approved by the Board

J M Taylor Director

Chas. R. Hetherington Director

Consolidated Statement of Exploration Expenditures

(thousands of dollars)	FOR THE YEAR ENDED DECEMBER 31 1988	1987	FROM INCEPTION TO DECEMBER 31 1988
Geological and Geophysical	$ 1	$ (299)	$ 72,810
Drilling (1)	1,620	8,903	224,845
Administrative and general (2)	(426)	3,294	58,785
Interest expense			
On long-term debt	-	-	22,829
Other	4	5	6,737
Crude oil sales	(5,171)	(6,139)	(17,293)
Crude oil transportation & marketing costs	3,186	3,028	9,529
Interest income	(1,311)	(848)	(8,596)
	(2,097)	7,944	369,646
Less: Petroleum Incentives Program grants	(1,232)	(5,650)	(102,679)
	$ (3,329)	$ 2,294	$266,967

(1) Net of recoveries from contract operations.
(2) Net of pension surplus refund of $3.4 million.

Consolidated Statement of Changes in Financial Position

(thousands of dollars)	FOR THE YEAR ENDED DECEMBER 31 1988	1987
Cash Provided By (Used In) Pre-Production Activities:		
Exploration expenditures	$ 2,097	$ (7,944)
Add: Depreciation and other non-cash items	1,652	2,618
	3,749	(5,326)
Petroleum Incentives Program grants	1,232	5,650
Purchase of equipment	(31)	(2,291)
Proceeds from sale of fixed assets	320	559
Net change in non-cash working capital balances	2,415	88
	7,685	(1,320)
Net increase (decrease) in cash during the year	7,685	(1,320)
Cash at beginning of year	12,161	13,481
Cash at end of year	$19,846	$12,161

Notes to Consolidated Financial Statements

December 31, 1988

1. ACCOUNTING POLICIES:

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Rigel Airways Ltd.

Inventory of Supplies

Inventories are recorded at average laid down cost in the Arctic.

Depreciation

Equipment is being depreciated over its estimated useful life by the straight-line method, mainly at the rate of 20%.

Exploration Expenditures

The activities of the Company are in the exploratory stage and all expenses less recoveries from contract operations and revenue realized on sale of crude oil production have been capitalized; the Company is deemed to have earned no profit and sustained no loss and therefore no income statement is submitted. The amount of Petroleum Incentives Program grants earned is accounted for as a reduction of exploration expenditures. To the extent that the exploration expenditures were incurred by shareholders in consideration for the issuance of common shares, share capital is also reduced by the related grants which are remitted to them.

Pension Plan

The Company has a defined contribution pension plan covering all employees. Company costs of the plan are charged to operations.

2. Equipment:

	December 31, 1988			Net Book Value December 31
	Cost	Accumulated Depreciation	Net Book Value	1987
	(thousands of dollars)			
Drilling equipment	$47,529	$47,506	$ 23	$ 50
Camps and buildings	5,816	5,816	–	13
Mobile equipment	4,819	4,769	50	56
Storage facilities	3,008	3,008	–	–
Production equipment	3,199	972	2,227	2,227
Bent Horn facilities	8,380	6,221	2,159	3,766
Aircraft	1,147	944	203	291
Radio & navigational equipment	1,610	1,598	12	34
Other	6,470	5,834	636	814
	$81,978	$76,668	$ 5,310	$ 7,251

Cost is original cost less any investment tax credits utilized to date. Depreciation recorded in 1988 and capitalized in exploration expense amounted to $1,809,000 (1987 - $3,060,000).

3. Income Taxes:

Under the terms of an agreement with the Government of Canada the Company has waived its right to claim expenditures for tax purposes of $80 million, an amount equal to the initial cash invested in shares of the Company by the Government. In addition, amounts expended on operations by shareholders as consideration for the issuance of shares of the Company are deductible for tax purposes by the shareholders and not by the Company.

As at December 31, 1988 the Company has the following pools available to apply against future taxable income:

	1989	Future Years	Total
	(thousands of dollars)		
Capital Cost Allowance	$3,000	$10,500	$13,500
Earned Depletion Allowance	–	13,600	13,600
	$3,000	$24,100	$27,100

Deductions for earned depletion are limited to 25% of production profits. In addition the Company has investment tax credits totalling $600,000. These credits, which expire between 1990 and 1992, may be applied against future federal income tax liabilities.

4 . Share Capital:

Warrants are outstanding which entitle the holders thereof to purchase an aggregate of 11,439,940 additional common shares at $1 per share. These warrants expire December 31, 1990 .

5. Contingencies and Commitments:

(a) The Company has substantially curtailed its exploration operations. The inventory of supplies, consisting primarily of fuel and drilling mud, which are not normally subject to physical deterioration has been valued at cost on the basis that the Company will continue as a going concern and utilize such inventory in future drilling operations in the Arctic. Should the Company be required to dispose of its inventory on a liquidation basis, the realizable value would be substantially less than the cost reflected in these financial statements.

(b) The recovery of exploration expenditures aggregating $267 million at December 31, 1988 is contingent upon the Company being able to achieve adequate commercial levels of production.

The Company has sold a limited amount of oil produced from a well at Bent Horn on Cameron Island in each of the last four years and plans shipments of oil from this area in 1989. It is presently anticipated that production of crude oil will continue beyond 1989 although there are no assurances that this will happen. Quantities will depend, among other things, on prevailing crude oil prices and the ability of the Company to continue to market such crude oil. Conditions in the Arctic place severe restrictions on the amount of access time available in any year to allow shipment of crude oil from the area . The company has established crude oil reserves other than at Bent Horn; however, production from such areas is not contemplated in the near future.

The Company has established substantial volumes of natural gas reserves in the Arctic; however, there has not been any commercial production of this product and none is expected in the near future. Construction of production and transmission facilities would require a substantial capital investment by the Company or others, which investment could not be undertaken by the Company unless the sales value of natural gas were to significantly increase and substantial new financing obtained . The likelihood of sales of natural gas from the Arctic Islands in the near future is considered remote.

(c) The Company has a lease agreement covering the rental of office facilities which expires January 31, 1993. The net rental obligations after subleases, amounts to approximately $1,300,000 annually.

Summary of Shareholders

	Common Shares
Petro-Canada Inc.	37,002,051
PanCanadian Petroleum Limited	5,558,080
Cominco Ltd.	4,280,915
Dome Petroleum Limited	4,259,953
Mosbacher Operating Ltd.	3,500,000
Home Oil Company Limited	3,168,130
Inco Limited	2,579,323
Noranda Inc .	2,381,394
Canada Northwest Energy Limited	1,587,322
Oakwood Petroleums Ltd .	1,100,457
Venwest Resources Limited	995,221
Bankeno Mines Limited	933,372
Bow Valley Industries Ltd.	910,371
Placer Dome Inc .	738,626
Norcen Energy Resources Limited	461,523
Musketeer Energy Ltd .	385,925
Sigma Mines (Quebec) Limited	82,181
Merritt, Robert Keith	40,000
Hetherington, Rose	30,934
Crombie, Ethel I.	30,000
Nesbitt Thomson Bongard Inc.	27,637
Canadian Superior Oil Ltd.	18,884
Henao, Diego	17,499
Connelly, E.	13,826
ICG Resources Ltd.	12,343
Armstrong, Jack Greaves	10,000
Tanner, B. C.	9,376
Alexander, K. Grey	8,000
Atco Drilling Holdings Ltd.	8,000
Pembina Resources Ltd.	7,688
Ultramar Oil & Gas Canada Ltd.	5,190
Place Gas & Oil Co. Ltd.	2,898
Luscar Ltd.	2,000
Estate of James E. Day	1,976
Franklin, Lindsay J.	490
Canadian Moran Ltd.	379
	70,171,964